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Venezuela: The Rise and Fall of a Petrostate

Venezuela's ongoing descent into economic and political chaos is a cautionary tale of the dangerous influence that resource wealth can have on developing countries.



Venezuelans protest against the results of the country's July 2024 presidential election, in Caracas. Maxwell Briceno/Reuters

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UPDATED

Last updated July 31, 2024 2:55 pm (EST)



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Summary

- Venezuela is an example of a petrostate, where the government is highly dependent on fossil fuel income, power is concentrated, and corruption is widespread.
- Petrostates are vulnerable to what economists call Dutch disease, in which a government develops an unhealthy dependence on natural resource exports to the detriment of other sectors.
- Venezuela continues to grapple with economic and political hardship under President Nicolás Maduro, but U.S. sanctions relief in exchange for democratic reforms have sparked hope for a revival of the oil industry.

Introduction

Venezuela, home to the world's largest oil reserves, is a case study in the perils of becoming a petrostate. Since it was discovered in the country in the 1920s, oil has taken Venezuela on an exhilarating but dangerous boom-and-bust ride that offers lessons for other resource-rich states. Decades of poor governance have driven what

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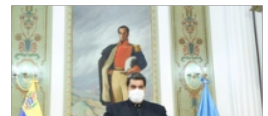
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by Elliott Abrams



Do U.S. Sanctions on Venezuela Work?

by Diana Roy



in the perils of becoming a petrostate. Since it was discovered in the country in the 1920s, oil has taken Venezuela on an exhilarating but dangerous boom-and-bust ride that offers lessons for other resource-rich states. Decades of poor governance have driven what was once one of Latin America's most prosperous countries to economic and political ruin.

In recent years, Venezuela has suffered economic collapse, with output shrinking significantly and rampant hyperinflation contributing to a scarcity of basic goods, such as food and medicine. Meanwhile, government mismanagement and U.S. sanctions have led to a drastic decline in oil production and severe underinvestment in the sector. Though Washington eased some sanctions on Venezuela's oil and gas sector in 2023, signaling a potential détente, Caracas's failure to meet conditions for a fair election prompted the U.S. government to reimpose sanctions in 2024.

What is a petrostate?

Petrostate is an informal term used to describe a country with several interrelated attributes:

- government income is deeply reliant on the export of oil and natural gas,
- economic and political power are highly concentrated in an elite minority, and
- political institutions are weak and unaccountable, and corruption is widespread.

Countries often described as petrostates include Algeria, Cameroon, Chad, Ecuador, Indonesia, Iran, Kazakhstan, Libya, Mexico, Nigeria, Oman, Qatar, Russia, Saudi Arabia, the United Arab Emirates, and Venezuela.

What's behind the petrostate paradigm?

Petrostates are thought to be vulnerable to what economists call **Dutch disease**, a term coined during the 1970s after the Netherlands discovered natural gas in the North Sea.



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Dutch disease, a term coined during the 1970s after the Netherlands discovered natural gas in the North Sea.

In an afflicted country, a resource boom attracts large inflows of foreign capital, which leads to an appreciation of the local currency and a boost for imports that are now comparatively cheaper. This sucks labor and capital away from other sectors of the economy, such as agriculture and manufacturing, which economists say are more important for growth and competitiveness. As these labor-intensive export industries lag, unemployment could rise, and the country could develop an unhealthy dependence on the export of natural resources. In extreme cases, a petrostate forgoes local oil production and instead derives most of its oil wealth through high taxes on foreign drillers. Petrostate economies are then left highly vulnerable to unpredictable swings in global energy prices and capital flight.

The so-called resource curse also takes a toll on governance. Since petrostates depend more on export income and less on taxes, there are often weak ties between the government and its citizens. Timing of the resource boom can exacerbate the problem. “Most petrostates became dependent on petroleum while, or immediately after, they were establishing a democracy, state institutions, an independent civil service and private sector, and rule of law,” says Terry Lynn Karl, a professor of political science at Stanford University and author of *The Paradox of Plenty*, a seminal book on the dynamics of petrostates. Leaders can use the country’s resource wealth to repress or co-opt political opposition.

How does Venezuela fit the category?

Venezuela is the archetype of a failed petrostate, experts say. Oil continues to play the dominant role in the country’s fortunes more than a century after it was discovered there. The oil price **plunge from more** than \$100 per barrel in 2014 to under \$30 per barrel in early 2016 sent Venezuela into an economic and political spiral, and despite rising prices since then, conditions remain bleak.

A number of grim indicators tell the story:

Oil dependence. In recent years, oil exports have financed **almost two-thirds** of the government’s budget. Estimates for 2024 place this figure slightly lower, at **58 percent**.

Falling production. Stalled or inadequate investment and

two-thirds of the government's budget. Estimates for 2024 place this figure slightly lower, at **58 percent**.

Falling production. Starved of adequate investment and maintenance, oil output has continued to generally decline, hitting its **lowest level in decades**. However, exports increased by some **12 percent** in 2023, due in part to an easing of U.S. sanctions on the country's oil and gas sector.

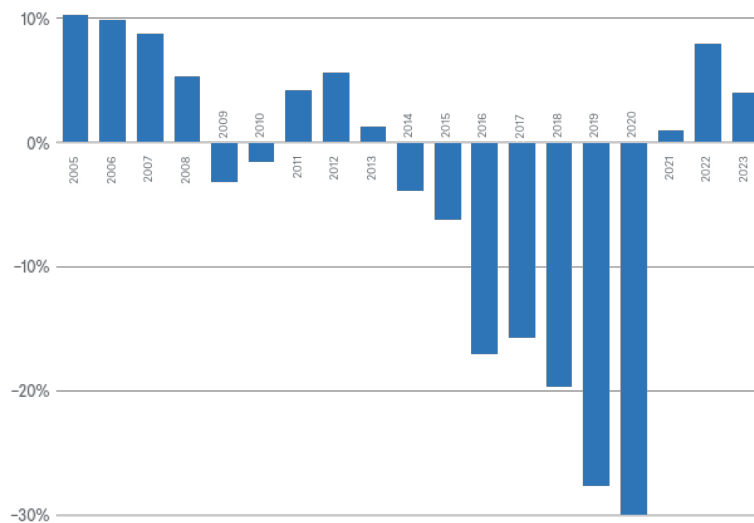
Turbulent economy. Venezuela's gross domestic product (GDP) shrank by **roughly three-quarters** [PDF] between 2014 and 2021. However, the economy **grew by 5 percent** in 2023, and the government forecasts it will reach 8 percent in 2024.

Soaring debt. Venezuela has an estimated debt burden of **\$150 billion or higher**.

Hyperinflation. Annual inflation skyrocketed to just over 130,000 percent in 2018, and though it has since slowed, it remained at **190 percent** in 2023, according to the central bank.

Venezuela's Economy Is Growing Again After Steep Decline

Annual percent change of real gross domestic product (GDP)



Source: International Monetary Fund.

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Growing autocracy. Over the last decade, President Nicolás Maduro and his allies have **violated basic tenets of democracy** to maintain power. This includes restricting internet access and arbitrarily prosecuting and detaining political opponents and critics.

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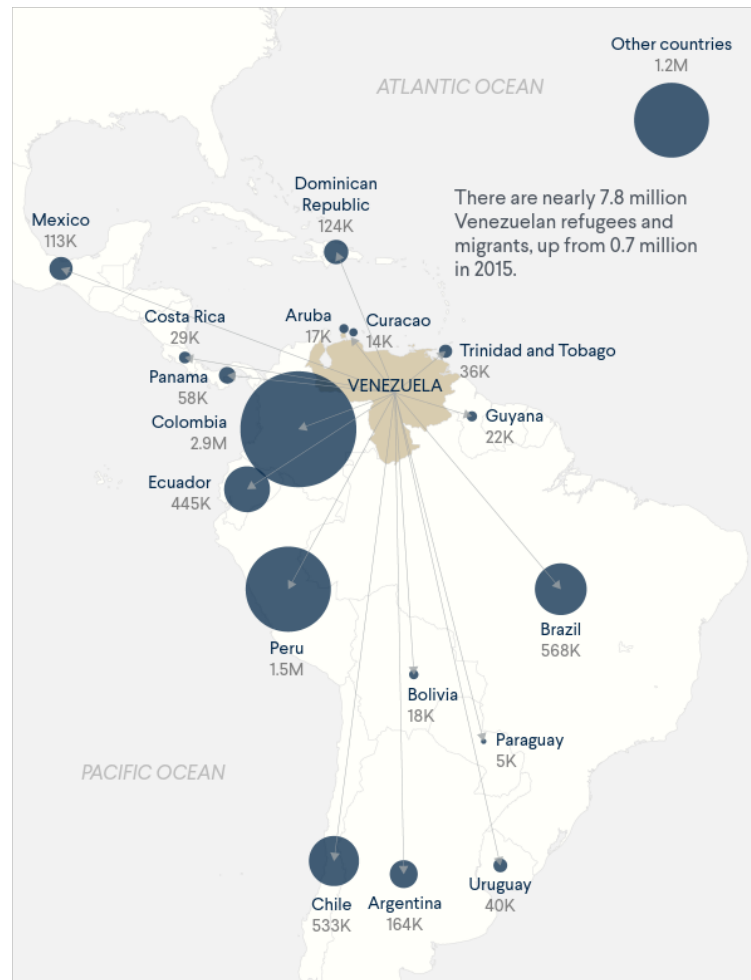
power. This includes restricting internet access and arbitrarily prosecuting and detaining political opponents and critics.

These issues—coupled with international sanctions and the ongoing repercussions of the COVID-19 pandemic—have fueled a devastating humanitarian crisis, with severe shortages of basic goods such as food, drinking water, gasoline, and medical supplies. According to a November 2022 survey, **50 percent** of Venezuela's 28 million residents live in poverty, though that is down from 65 percent the year before.

Since 2014, nearly **eight million** Venezuelan refugees have fled to neighboring countries and beyond, where some governments have granted them temporary residency. Venezuela's Ministry of Foreign Affairs says that more than three hundred thousand Venezuelan migrants have returned home since September 2020.

The Exodus From Venezuela

Estimated refugees and migrants in 2024 or the most recent year available



Source: Regional Inter-Agency Coordination Platform for Refugees and Migrants From Venezuela (R4V).

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Country	Migration
Chile	533K
Argentina	164K
Other	40K

Source: Regional Inter-Agency Coordination Platform for Refugees and Migrants From Venezuela (R4V).

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How did Venezuela get here?

A number of economic and political milestones mark Venezuela's path as a petrostate.

Discovering oil. In 1922, Royal Dutch Shell geologists at La Rosa, a field in the Maracaibo Basin, struck oil, which blew out at what was then an extraordinary rate of one hundred thousand barrels per day. In a matter of years, more than one hundred foreign companies were producing oil, backed by dictator General Juan Vicente Gómez (1908–1935). Annual production **exploded during the 1920s** [PDF], from just over a million barrels to 137 million, making Venezuela second only to the United States in total output by 1929. By the time Gómez died in 1935, Dutch disease had settled in: the Venezuelan bolívar had ballooned, and oil shoved aside other sectors to account for over **90 percent** of total exports.

Reclaiming oil rents. By the 1930s, just three foreign companies—Gulf, Royal Dutch Shell, and Standard Oil—controlled **98 percent** of the Venezuelan oil market. Gómez's successors sought to reform the oil sector to funnel funds into government coffers. The **Hydrocarbons Law of 1943** was the first step in that direction, requiring foreign companies to give half of their oil profits to the state. Within five years, the government's income had increased sixfold.

Punto Fijo pact. In 1958, after a succession of military dictatorships, Venezuela elected its first stable democratic government. That year, Venezuela's three major political parties signed the **Punto Fijo pact**, which guaranteed that state jobs and, notably, oil rents would be parceled out to the three parties in proportion to voting results. While the pact sought to guard against dictatorship and usher in democratic stability, it ensured that oil profits would be concentrated in the state.

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OPEC. Venezuela joined Iran, Iraq, Kuwait, and Saudi Arabia as a founding member of the **Organization of the Petroleum Exporting Countries** (OPEC) in 1960. Through the group, which would later include Qatar, Indonesia, Libya, the United Arab Emirates, Algeria, Nigeria, Ecuador, Gabon, Angola, Equatorial Guinea, and the Republic of Congo, the world's largest producers coordinated prices and gave states more control over their national industries. That same year, Venezuela established its first state oil company, the Venezuelan Petroleum Corporation, and increased oil companies' income tax to 65 percent of profits.

The 1970s boom. In 1973, a five-month OPEC embargo on countries backing Israel in the Yom Kippur War quadrupled oil prices and made Venezuela the country with the **highest per-capita income** in Latin America. Over two years, the windfall added \$10 billion to state coffers, giving way to rampant graft and mismanagement. Analysts estimate that as much as **\$100 billion was embezzled** between 1972 and 1997 alone.

PDVSA. In 1976, amid the oil boom, President Carlos Andrés Pérez nationalized the oil industry, creating state-owned *Petróleos de Venezuela, S.A.* (PDVSA) to oversee all exploring, producing, refining, and exporting of oil. Pérez allowed PDVSA to partner with foreign oil companies as long as it **held 60 percent equity** in joint ventures and, critically, structured the company to run as a business with minimal government regulation.

The 1980s oil glut. As global oil prices plummeted in the 1980s, Venezuela's economy contracted and inflation soared; at the same time, it accrued massive foreign debt by purchasing foreign refineries, such as Citgo in the United States. In 1989, Pérez—reelected months earlier—launched a fiscal austerity package as part of a financial bailout by the **International Monetary Fund**. The measures provoked deadly riots. In 1992, Hugo Chávez, a military officer, launched a failed coup and rose to national fame.





Timeline

Venezuela's Chavez Era

1958–2013

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Chávez's Bolivarian revolution. Chávez was elected president in 1998 on a socialist platform, pledging to use Venezuela's vast oil wealth to reduce poverty and inequality. While his costly "**Bolivarian missions**" expanded social services and reduced poverty by some 20 percent, he also took several steps that precipitated a **long and steady decline** in the country's oil production, which peaked in the late 1990s and early 2000s. His decision to fire thousands of experienced PDVSA workers who had taken part in an industry strike in 2002–2003 gutted the company of important technical expertise. Beginning in 2005, Chávez provided subsidized oil to several countries in the region, including Cuba, through an alliance known as Petrocaribe. Over the course of Chávez's presidency, which lasted until 2013, strategic petroleum reserves dwindled and **government debt more than doubled** [PDF].

Chávez also harnessed his popularity among the working class to expand the powers of the presidency and edged the country toward authoritarianism: he **ended term limits**, effectively took control of the Supreme Court, harassed the press and closed independent outlets, and nationalized hundreds of private businesses and foreign-owned assets, such as oil projects run by ExxonMobil and ConocoPhillips. The reforms paved the way for Maduro to establish a dictatorship years after Chávez's death.

Descent into dictatorship. In mid-2014, global oil prices tumbled and Venezuela's economy went into free fall. As unrest brewed, Maduro consolidated power through political repression, censorship, and electoral manipulation. In 2018, he secured reelection in a race widely condemned as **unfair and undemocratic**. Nearly sixty

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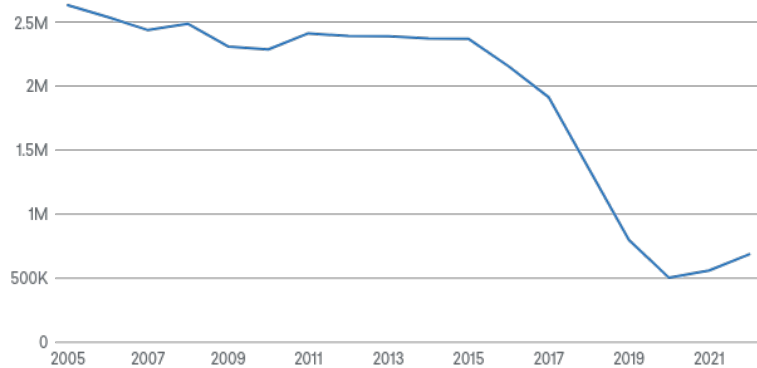
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Venezuela's economy went into free fall. As unrest brewed, Maduro consolidated power through political repression, censorship, and electoral manipulation. In 2018, he secured reelection in a race widely condemned as **unfair and undemocratic**. Nearly sixty countries, including the United States, subsequently recognized opposition figure Juan Guaidó, head of the National Assembly, as Venezuela's interim leader.

Venezuela's Oil Output Has Been Dropping for Years

Crude oil production (barrels per day)



Source: Organization of the Petroleum Exporting Countries.

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What has been the impact of U.S. sanctions?

For almost two decades, Washington has **imposed sweeping sanctions** against Caracas, the most significant of which have blocked oil imports from PDVSA and prevented the government from accessing the U.S. financial system. Still, Venezuela has retained oil-trading partners, and analysts say that support from China, Cuba, Iran, Russia, and Turkey has helped keep the Maduro regime afloat.

In January 2021, Maduro and his allies took leadership of what was the last opposition-controlled power center in the government, the National Assembly, after claiming victory in legislative elections. The opposition, including Guaidó, boycotted the vote, alleging that it was fraudulent, a charge reaffirmed by the Joe Biden administration and other foreign governments and international bodies, including Canada, the European Union, and the **Organization of American States**. However, regional elections that November **further cemented Maduro's power** and saw the fractured opposition win only three of twenty-three available governorships. After years of waning support, the opposition voted to remove Guaidó and dissolve his government in December 2022.

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Meanwhile, U.S.-Venezuela relations have begun seeing signs of a thaw. In November 2022, in part to help offset rising global energy prices due to the war in Ukraine, the United States permitted U.S. oil giant Chevron to resume limited operations in the country. In exchange, the Maduro government and the opposition agreed to continue dialogue following a yearlong stalemate. The following October, Caracas agreed to a roadmap for a free and fair presidential election in 2024.

Washington rewarded the move by further easing sanctions on Venezuela's oil and gas sector, allowing it to export oil and gas products for six months. However, after the Venezuelan government's failure to meet conditions for a fair vote and the revival of a centuries-old territorial dispute with Guyana over control of the oil-rich Essequibo region, Washington reimposed oil sanctions in April 2024. Relations have become further strained in the wake of Venezuela's July 2024 presidential election, which saw the Maduro government and opposition both claim victory, with the United States among the many countries voicing concerns.

Is there a path away from the oil curse?

A country that discovers a resource after it has formed robust democratic institutions is usually better able to avoid the resource curse, analysts say. For example, strong institutions in Norway have helped the country enjoy steady economic growth since the 1960s, when vast oil reserves were discovered in the North Sea, Karl writes in her book. In 2024, officials project that the petroleum sector will account for just 20 percent of Norway's GDP. Strong democracies with an independent press and judiciary help curtail classic petrostate problems by holding government and energy companies to account.

If a country strikes oil or another resource before it develops its state infrastructure, the curse is much harder to avoid. However, there are remedial measures that low-income and developing countries can try, provided they are willing. For instance, a government's overarching objective should be to use the oil earnings in a responsible manner "to finance outlays on public

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countries can try, provided they are willing. For instance, a government's overarching objective should be to use the oil earnings in a responsible manner "to finance outlays on public goods that serve as the platform for private investment and long-term growth," says Columbia University's Jeffrey Sachs, an expert on economic development. This can be done financially, with broad-based investing in international assets, or physically, by building infrastructure and educating workers. Transparency is essential in all of this, Sachs says.

Many countries with vast resource wealth, such as Norway and Saudi Arabia, have established sovereign wealth funds (SWF) to manage their investments. As of 2023, SWFs managed more than **\$11 trillion** worth of assets, and some analysts predict that figure will grow to nearly \$13 trillion by 2025.

Analysts anticipate that a global shift from fossil fuel energy to renewables such as solar and wind will force petrostates to diversify their economies. Nearly two hundred countries, including Venezuela, have joined the **Paris Agreement**, a binding treaty that requires states to make specific commitments to mitigate climate change.

Economic diversification will be an especially difficult climb for Venezuela given the scale of its economic and political collapse over the last decade. The country would likely need to revitalize its oil sector before it could cultivate and develop other important industries. But this would take enormous investment, which analysts say would be hard to come by given Venezuela's unstable political environment, trends in oil demand, and rising concerns about climate change.

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CFR's Center for Preventive Action tracks **instability in Venezuela**.

Bloomberg's Andreina Itriago Acosta and Nicolle Yapur lay out why recent U.S.-Venezuela talks can be seen as a step toward **restoring Venezuela's democracy**.

For *Foreign Affairs*, Jose Ignacio Hernández argues there is still a **path to democracy** in Venezuela despite Maduro's claim of victory.

Freedom House's 2023 Freedom in the World report ranks Venezuela as one of the **least free countries in Latin America**.

For *Americas Quarterly*, Luisa Palacios writes about how Venezuela's election **has implications** for the country's global energy transition and climate goals.

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This **2023 report** [PDF] by Abraham F. Lowenthal for the Wilson Center discusses why negotiations between the government and opposition are important for resolving Venezuela’s prolonged political crisis.

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William Rampe and Rocío Cara Labrador contributed to this report. Will Merrow helped create the graphics.

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